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SUBJECT: CHINA ANNOUNCES MACHINERY INDUSTRY SUPPORT PLAN

REF: A. BEIJING 151
[1](#)B. BEIJING 326

[1](#)1. (SBU) SUMMARY. China's State Council announced February 4 a plan to support China's machinery industry, part of the government's campaign to bolster the country's slowing economy. The plan aims to support the domestic machinery industry and reduce reliance on imported parts without running awry of China's WTO commitments. A government researcher downplayed concerns about protectionist measures, stressing that joint ventures and foreign-owned machinery enterprises in China would also benefit from the support measures. Industry sources welcomed the plan but expressed concerns about the stimulus package and industry support plans leading to duplication and overcapacity. End Summary.

[1](#)2. (U) At a February 4 meeting of the State Council, Premier Wen Jiabao approved a plan to support China's machinery industry. The machinery industry support plan is the fourth of ten plans to provide a boost to sectors hard-hit by the economic downturn (see Ref A-B for auto, steel and textile industry support plans). The plan includes the following measures: 1) promote domestically-produced machinery, particularly for "priority projects" in infrastructure construction of high-speed railway, subway, natural gas pipeline transportation, liquefied natural gas (LNG) storage and transportation, mining, clean and efficient power generation, and extra-high voltage (EHV) power transmission; 2) use key projects of large industries such as steel, autos and textiles to promote domestically-produced machinery; 3) encourage mergers and consolidation of pillar enterprises in the industry; 4) increase lending to encourage machinery exports and exempt tariffs and VAT on imports of raw materials and key machinery parts; and 5) establish a risk compensation mechanism for the first use of domestically-produced machinery. After the plan was announced, there was a sharp rise in machinery stocks on the Shanghai and Shenzhen markets.

"No Need to Worry about Protectionist Measures"

[1](#)3. (SBU) According to State Council Development Research Center Deputy Director General Shi Yao Dong, one of the plan's strong points is the government's encouragement of innovation and support for domestically-produced technology and products. Shi said China's machinery industry is weak in the production of machinery parts and high-end technologies, resulting in a tendency to import many key parts and components. Approximately 70 percent of important machinery parts in China are imported from overseas. This problem is compounded by a lack of R&D investment and poor coordination between industries, industrial associations and research institutions. Shi predicted that the support measures would help domestic producers by promoting innovation and improving coordination between industry and research institutions. However, he stressed that all machinery enterprises in China, including joint ventures and foreign firms operating in China, can benefit from

these measures. He claimed the plan is consistent with China's WTO commitments, adding that "there is no need to worry about protectionist measures."

Industry Welcomes the Plan, Eager for More Details

14. (SBU) The machinery industry welcomes the support plan, said China Machinery Industry Federation Department of International Cooperation Director Yang Junmian, whose Federation includes more than 50 machinery industry associations and institutions. She said the plan will provide a much-needed boost to machinery companies hard-hit by the global economic slowdown. Measures to promote domestically-produced machinery, including the proposed risk compensation mechanism for trialing Chinese-made machinery, are particularly welcome by industry. Yang said the risk compensation mechanism should help domestic producers, whose machinery is often passed over for large-scale projects in favor of high-quality imported machinery. She speculated that funds for this mechanism would come from the central government, local governments and companies themselves. Song Xiaogang, Deputy Secretary General of the Federation, said he has heard positive feedback from companies regarding the plan to set up a special fund to promote R&D of machinery parts. He said the plan to promote domestically-produced industry was a sign that the government recognizes the industry's potential impact on the country's economic security. However, both Song and Yang acknowledged that the plan is short on details and said companies are eagerly awaiting more details on the plan.

Concerns about Duplication and Overcapacity

15. (SBU) According to Yang, the plan complements the government's four trillion yuan (USD 585 billion) stimulus package, which will

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fund many large-scale infrastructure projects requiring machinery. However, Yang expressed concerns about the possibility of the government duplicating projects and generating overcapacity. She noted that the NDRC, which faces the difficult task of coordinating much of the spending of the stimulus package and industry support plans, may find it hard to avoid funding some unnecessary projects or funding duplicative projects in different provinces. Lu Tie, a Chinese Academy of Social Sciences (CASS) Institute of Industrial Economics Researcher, shared these concerns. He said local government officials were seeking stimulus package funds to protect local jobs, funds which would inevitably be used to save some factories that should be eliminated.

Industry Consolidation Likely to Benefit SOEs

16. (SBU) One goal of the plan is to promote industry consolidation. Most machinery companies are small or medium-sized, with some large machinery factories concentrated in China's north-east provinces, Sichuan Province and central China. Yang said the government's plan to encourage consolidation would likely benefit large-scale "backbone enterprises," most of which are state-owned enterprises (SOEs) under the supervision of the State Council's State-Owned Assets Supervision and Administration Commission (SASAC). She noted that SASAC would probably take the lead in promoting consolidation with the long-term goal of improving the competitiveness of SOEs.

Comment

17. (SBU) Despite our contacts' assurances that the plan does not have protectionist measures, the plan includes a number of measures that may be inconsistent with China's G-20 pledge. The clear support for domestically-produced machinery is troubling as it appears to discriminate against imports. The proposed risk compensation mechanism and R&D fund appears aimed at boosting the use of domestic machinery instead of imported products. Although joint ventures and foreign firms operating in China could benefit from support measures, it is also possible that the government would give priority to China's large SOEs, particularly for large-scale infrastructure projects. Unfortunately, the announced plan offers few details on how the government will actually implement the plan, including such measures as the risk compensation mechanism and R&D fund. However the plan is implemented, it appears that the big

winners will likely be China's large SOEs. End Comment.

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